

Q&A

Q. Can my existing California businesses re-incorporate or re-register in another state or form out-of-state corporations to transfer its profits outside California?

A. It does not work that way. Businesses with business income from sources both within and outside California must apportion their income and pay California tax. See California Schedule R, Apportionment and Allocation of Income, for more details about this requirement.

When two or more businesses are under common ownership they may be unitary, which means we view all of the activities comprising a single trade or business as a single unit. This is irrespective of whether those activities are conducted by divisions of a single corporation, or commonly owned, or by controlled corporations. The business income from the unitary business activities is combined and apportioned to California.

Q. Does a business incorporated or registered in another state, but not qualified to do business in California, have the same legal standing as a business incorporated or qualified in California?

A. No. If you are doing business here, but are not qualified to do business here, your company does not have legal standing in California.

A company may not file suit nor defend itself in California courts. Since it is not an "entity" recognized in California, any contracts entered into by the company can be voided.

Q. Does California recognize Series Limited Liability Companies (LLC)?

A. Yes, California currently recognizes a Series LLC. A Series LLC is a relatively new form of ownership for California purposes. In essence, a Series LLC is a master LLC with separate divisions operating independently under the master LLC. Each division (a.k.a., series) has its own assets and liabilities, is managed independently, must maintain separate books and records, and may

operate a business that is separate and distinct from all other entities included in the Series LLC.

The classification of an eligible business entity for California tax purposes shall be the same as the classification of the entity for federal tax purposes. Currently, the IRS has not provided any guidance on whether a series within a Delaware Series LLC (e.g., *most common Series LLC*) is a separate entity or part of a single Series LLC entity. **The Franchise Tax Board has taken the position that a series within the Series LLC will be considered a separate business entity if:** (1) the holders of interests in that series are limited to the assets of that series upon redemption, liquidation, or termination, and may share in the income only of that series; and (2) under state law, the payment of the expenses, charges, and liabilities of that series is limited to assets of that series. Each series that is a separate business entity and registered or doing business in California must file their own California tax return, pay the annual tax, and may be subject to a fee based on total annual income.

Forms and Information

For more information, see our following publications:

- FTB Publication 1060, *Guide for Corporations Starting Business in California*.
- FTB Publication 1061, *Guidelines for Corporations Filing a Combined Report*.
- FTB Publication 1063, *California Corporation Tax Law – A Guide for Corporations*.
- FTB Publication 1050, *Application and Interpretation of Public Law 86-272*.
- FTB Publication 1031, *Guidelines for Determining Resident Status*.

To obtain tax forms and publications from the Franchise Tax Board, you can do any of the following:

- Visit our Website at www.ftb.ca.gov.
- Call us at (800) 338-0505.

Don't Gamble With Your Taxes: Read the Fine Print About Incorporating in Nevada



The Franchise Tax Board PROVIDES ANSWERS to QUESTIONS YOU SHOULD BE ASKING

Ever wonder about those ads that promise big tax savings for incorporating in Nevada? While there is nothing inherently wrong with incorporating or registering in Nevada or any other state for that matter, we do see many instances where taxpayers run into problems.

Since we get many questions about this issue, we decided to publish this brochure to dispel some of the myths about avoiding California taxes by incorporating out-of-state.

Q&A

Q. What is the controversy?

A. Some tax planning advisors and promoters are encouraging businesses, many of which only operate in California, to incorporate or register in non-income or non-franchise taxing states such as Nevada or Delaware. While it may make sense for some multi-state businesses to incorporate elsewhere, we believe some of the services offered by these promoters could cause California taxpayers to engage in illegal tax strategies.

Q. Will incorporating or registering in another state save me money?

A. Probably not. Your corporation tax is determined by where you do business. If you have any business activities in California, you may owe California tax regardless of where you incorporate. Many promoters charge fees for setting up an out-of-state corporation or other business entity, to maintain an out-of-state address, telephone, fax, receptionist service, and other services to retain the appearance of being located in another state. These fees often offset any potential reduction in tax and can possibly exceed the California tax that is rightfully owed.

Also, we can disregard business entities when their creation was solely for tax avoidance purposes. Businesses that receive payments for no other reason than to divert income out-of-state may be considered shams that lack economic substance. Those responsible for the sham entities may be subject to civil or criminal penalties.

Q. Will incorporating in another state protect my shareholder's identity?

A. Not necessarily. We have access to many data sources including third-party information such as the IRS, other state agencies, and businesses. We also contact the Secretaries of State in other states to obtain public information about incorporating entities.

We use this information to identify taxpayers who likely have California tax obligations. Forming a corporation to protect your personal liability is allowed under California law. However, forming a corporation simply to hide income earned in California is not legitimate. Privacy laws do not protect fraudulent activities.

Does your business fit this description?



Q. If I incorporate, register, or form a business outside California, will I be required to pay California tax?

A. Yes, if your business is operating in California or deriving income from a California source, it is subject to California tax. For example, if a business directly or indirectly holds California real property that generates income, the business has a California tax filing requirement and may owe tax in California.

In addition to any income apportioned to California, a corporation with a California commercial domicile will be subject to California tax on any income not subject to apportionment. Generally, an out-of-state corporation is commercially domiciled in California if its principal office or place of business is located here, or if its business is managed or controlled from California. Holding an annual Board of Directors meeting out-of-state or assigning an out-of-state agent is not sufficient to establish corporate operations outside California.

In addition, we tax a California resident individual on income from all sources, including wages received from an out-of-state corporation. Thus, even if your corporation does business entirely outside of California, a California resident will be taxed on wages paid to them by such corporation.